Your Money

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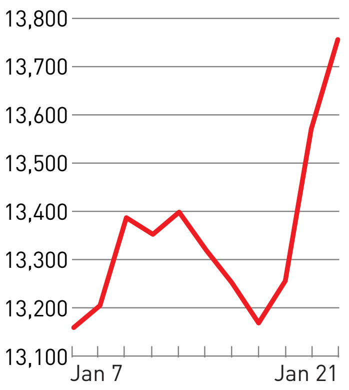
HANG SENG INDEX



SMP Graphic Source: Reuters

Leading Hong Kong stocks rang out the Year of the Ram with a bang last week as investors continued to snap up property and banking counters on growing optimism of a continuing rally. The Hang Seng Index gained 4.43 per cent for the week to finish at 13,750.58, a fresh 2½-year high. The property sub-index again outpaced the broader market, climbing to 18,059.93. "Property and banking shares have helped push the market higher as the real-estate sector has improved," said Francis Kwok, a director at Peace Town Securities. *Reuters*

DOW JONES IND AVERAGE

SMP Graphic Source: Reuters

The path of least resistance may be down for Wall Street this week as expectations for strong fourth-quarter scorecards have already fuelled a hefty rally.
"My feeling really is that next week there will be consolidation of the market," said Stanley Nabi, managing director at Credit Suisse Asset Management."
For the week, the Dow slipped 0.30 per cent to 10,568.29 and the Nasdaq fell 0.78 per cent to 2123.87. The S&P, however, rose 0.15 per cent to 1,141.55.
Earnings season adds more pressure this week with reports from about 140, or almost 30 per cent, of the companies in the S&P's 500 index. *Reuters*

NEW PRODUCTS

Feeling uncertain about the sustainability of the global economic recovery?
The ABN Amro Guaranteed Fund is custom-designed for those sceptical about the road ahead, offering a potential yield of 8 per cent in as little as 1½ years.
"The fund is ideal for those who are uncertain about the sustainability of the economic growth," says ABN Amro's head of structured asset management, Solange Rouschop.
In addition to a 6 per cent guaranteed coupon in the first year, the fund will hand out additional coupons ranging between 1.5 and 2.5 per cent.
The additional coupons are based on the performance of a basket of five Hang Seng Index blue-chip stocks.
"In a best-case scenario, the additional coupons, added to the guaranteed coupons, can deliver a total of return of 8 per cent in as little as 1.5 years from the start date," a spokesman says. In the worst-case scenario investors will receive a 108 per cent return over the six-year term of the fund.

EXCHANGE RATES

HK$	Bid	Ask
£	14.1829	14.1886
SFr	6.2588	6.2622
*¥	7.2774	7.2804
S$	4.5797	4.5830
A$	5.9831	5.9877
C$	5.9111	5.9877
Baht	0.1985	0.1985
NZ$	5.2196	5.2280
*Won	0.6555	0.6561
M$	2.0437	2.0445
NT$	0.2309	0.2313
Euro	9.7766	9.7776
Peso	0.1394	0.1398
Yuan	0.9300	0.9450

Rates yesterday * per 100 units

A red-chip conglomerate and a Nasdaq-listed mainland phone manufacturer illustrate different approaches to China investing

Long and short plays

Andy Mantel

When investing in China, it is a good idea to consider the entire universe of China-related stocks. Many of the best investment opportunities are to be found not in Shanghai or Hong Kong, but on the technology-heavy Nasdaq or Wall Street.

More than 2,500 listed companies worldwide derive more than 50 per cent of revenue and earnings from the mainland, or mainland-related activities.

In order to leverage China's high economic growth prospects, it is wise to diversify among industries and assets. It is also important to short sell stocks in order to take advantage of specific arbitrage opportunities on both sides of the equation.

China-related stocks in general have had a good run in the past year. With this in mind, I am going to recommend two stocks – one Nasdaq-listed – that deserve a closer look.

Hong Kong-listed China Resources Enterprise (291) has interests in food processing and distribution in Hong Kong (through the wholly-owned Ng Fung Hung), breweries in China, consumer retail chains, textile manufacturing and distribution, and petrochemical distribution. It also has a construction materials division, investment properties, and a 10 per cent stake in Hong Kong container terminal operator HIT, which is controlled by Hutchison.

In late 2002 China Resources announced it was pursuing a retail-led distribution strategy on the mainland. Its goal is to become China's largest consumer goods retailer by investing five billion yuan in the sector by 2006.

Still in the early stages of its plan, the company last year became the mainland's second-largest retailer after acquiring 65 per cent of China's largest hypermarket chain Shenzhen Vanguard. It also acquired Jiangsu Suguo, the largest supermarket operator in Jiangsu Province.

Focused on its new consumer retail strategy, China Resources is also unloading non-core assets such as Redlands Concrete which it sold in March last year.

After the Sars outbreak was contained, business improved significantly throughout the second half of last year and is expected to continue to do well. During the third quarter revenue was up 13.7 per cent to HK$8.85 billion, while profit was up 3.2 per cent to HK$372 million from the same period a year earlier.

Compared to other red-chip conglomerates, China Resources ranks better because of its solid core business, and strategic focus on the fast-growing coastal regions. Unlike others, it also has more direct control over its businesses. The company's strong balance sheet (11 per cent net debt to equity ratio, according to financial records for 2002) means China Resources is well placed to leverage its retail strategy in the next few years.

CHINA RESOURCES ENTERPRISES

Source: Bloomberg SMP Graphic

The company has a valuation of 12 times this year's earnings with a 4 per cent dividend yield.

The stock is also poised to become a favourite of mainland investors once the inevitable Qualified Domestic Institutional Investor scheme (QDII) is implemented.

My second recommendation is a short position in Qiaoxing Universal Telephone, which manufactures and supplies fixed-line and mobile telephones in China. The company was listed on Nasdaq in February 1999.

Since early 2000 there has been a massive consolidation in the fixed-line manufacturing industry and Qiaoxing has lost market share. As a result, product prices shrank dramatically and in 2002 the company's gross profit margin turned negative for the first time.

Qiaoxing sold its entire corded telephone manufacturing business in December 2002 and used the proceeds to buy a 65 per cent stake in Beijing-based mobile-phone manufacturer CEC Telecom last February.

In 2002, revenue reached US$66.4 million with a profit of US$1.9 million, compared to revenue of US$30.1 million and a loss of US$2.6 million the year before. However, minus the sale of the fixed-line subsidiary at a profit of US$9.5 million, the company would have had a net loss of about US$7.6 million in 2002.

Despite generally favourable market conditions in China's telecommunications industry, the mobile handset manufacturing business is extremely competitive.

Best estimates suggest the demand for handsets in China in 2004 should reach about 40 million. Unfortunately production capacity is about 200 million handsets. Despite the overcrowded market, both domestic and foreign players continue to announce major expansion plans.

Many of Qiaoxing's competitors have recently announced profit warnings. And to complicate matters further, the company does not provide quarterly reports, despite pressure from the investment community to adopt the practice.

Communication is by random press releases, such as a recent one that announced that the mobile business sold 200,000 units of a new mobile phone model at an average cost of 1,900 yuan each – double the price of comparable handsets.

What was not disclosed was that the phones were most likely sold to a single distributorship called Calilee Telecommunications, a company controlled by the son of Qiaoxing's chairman.

Aside from one sell-side research group that has a positive recommendation on the stock, the company is otherwise not covered by local analysts. Once trading above US$50 a share, Qiaoxing became a penny stock in late 2002. The share price has recently rebounded to about US$15 a share on the back of strong liquidity flows this year.

The stock is presently valued at more than 150 times price to earnings, with a price to sales at about four times based on its present market capitalisation of around US$225 million.

Andy Mantel is managing director of Pacific Sun Investment Management and manager of The China Mantou Fund.

"It is wise to diversify among industries and asset classes in order to leverage China's high growth prospects"

Focus of portfolio to shift this year

INVESTMENT TIPS
PAUL PONG

Heavy selling of Hong Kong stocks in the Sars panic last year made for a sharp V-shaped rebound once the outbreak was under control.

Despite Sars – and fears sparked by the Iraq war – in the first half, the Year of the Sheep was positive overall for the market. H shares led the way as the China Enterprise Index climbed a phenomenal 121.34 per cent. The Hang Seng Index returned 49.78 per cent.

Readers should prepare for a shift in investment focus in this year's portfolio to reflect growth in domestic consumption.

Last year, I was generally correct in my forecast that a V-shape rebound would define the post-April market, as it was heavily oversold relative to fundamentals. Once Sars was under control, the market kicked off and never looked back.

The benchmark Hang Seng Index was at 9,201.76 when my portfolio was launched in February last year, and fell to 8,409.01 by April. At Wednesday's closing the index finished at 13,750.58, a gain of 63.52 per cent from the Sars low. My portfolio, with a heavier weighting of the China-related plays and H shares, yielded a return somewhere between the two indices.

Since inception it grew 61.64 per cent to HK$3.23 million from its initial investment of HK$2 million.

Among the stocks in my portfolio as at last Wednesday, Lung Kee was the star performer, rising 127.20 per cent for the year since its inclusion in March. Zhejiang Expressway, China Merchant Holdings and Angui Expressway also performed well, and were kept in the portfolio. I would have no intention of removing them if it wasn't time to start with a clean slate and structure a new column for the Year of Monkey. I may consider buying these shares for the new portfolio.

The largest fall in the share prices of companies in my portfolio over the past three weeks was PetroChina, which suffered a strong correction after rising more than 40 per cent without pause. The mainland oil giant slid 16 per cent over the past two weeks to HK$4.07 at Wednesday's closing. The unsettling repercussions of a gas-well explosion that killed 250 people was probably the trigger point for investors to take profits.

According to state television, investigators are accusing PetroChina's parent of committing a series of safety violations, which leaves it potentially exposed to lengthy lawsuits for negligence. As a result, the overhang might limit the near-term upside for the company.

PEGASUS' PORTFOLIO

Stock	No of shares	Average Entry price	Current price	Market Value
Anhui Expressway	104,000	$1.78	$2.95	$306,800
BOC Hong Kong	15,000	$14.475	$14.75	$221,250
Chiahsin Cement	52,000	$2.05	$2.00	$104,000
China Life	50,000	$5.07	$6.10	$305,000
China Merchants Holdings	16,000	$5.90	$11.30	$180,800
Cosco Pacific	28,000	$6.725	$11.60	$324,800
HK Exchanges and Clearing	14,000	$15.95	$20.60	$288,400
Huaneng Power	12,000	$10.40	$13.55	$162,600
Jiangsu Expressway	72,000	$2.61	$3.925	$282,600
Lung Kee	48,000	$2.025	$4.60	$220,800
PetroChina	54,000	$2.725	$4.075	$220,050
Tack Fat	176,000	$0.53	$0.78	$137,280
TPV Technology	32,000	$2.15	$3.975	$127,200
Zhejiang Expressway	62,000	$3.01	$5.50	$341,000

Starting capital: $2 million
Total portfolio value: $3,232,730
Portfolio gain: $1,232,730
Cash (excluding dividends and trading costs): $10,150

Hang Seng Index gain
(February 22, 2003 – January 21, 2004): **49.78%**
Portfolio gain
(Feb 22, 2003 – Jan 21, 2004): **61.64%**
H-share index gain
(Feb 22, 2003 – Jan 21, 2004): **121.34%**

Looking ahead, Hong Kong's economy is likely to grow and be more prosperous in the Year of Monkey. On the political side, the July 1 demonstration last year by more than half a million people marked the bottom of the political cycle. On the economic side, Hong Kong is set to benefit from reflationary measures brought in by mainland authorities. These include lower tariffs on Hong Kong exports to the mainland; relaxation of individual tourist travel to Hong Kong; relaxed capital flows; and several infrastructure projects that are now on the drawing board.

As domestic consumption is expected to grow more than exports this year, my investment focus will lie more on retail, financial and technology plays as well as stocks with strong China themes. Readers will also notice less emphasis upon industrial plays such as my last year's favorites Yue Yuen and Tack Fat.

Financial stocks should further benefit from the Closer Economic Partnership Agreement (Cepa), as it would allow Hong Kong banks to provide personal yuan banking services. They are also permitted to offer yuan lending services to domestic Chinese enterprises, effectively giving a head start to local banks relative to foreign institutions. As a result, investors should continue to hold BOC Hong Kong in their portfolio.

I will be back next week with more ideas on how to put your money to work for the year ahead!

Paul Pong is managing director of Pegasus Fund Managers

WHAT THE BROKER SAYS

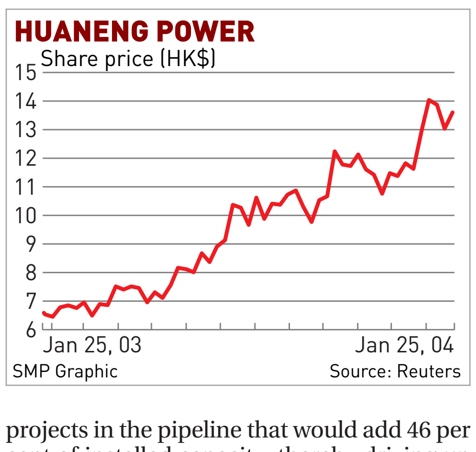
Earnings of mainland power giant Huaneng Power International (HPI) this year will be driven higher by recently acquired generating plant, supported by a high utilisation rate of about 70 per cent, says Core Pacific-Yamaichi, which has maintained its "buy" recommendation on the stock.

HPI produced 90.91 billion kilowatt hours of power last year, up 27.3 per cent year on year. The increase was due mainly to the acquisition of four plants in eastern China and the opening of two generation units at the Dezhou plant.

HPI has signed a contract to secure about 65 per cent of its coal needs this year for about 12 yuan per tonne more than last year, reducing the risk from possible coal price rises. The impact of the higher price will be reduced as power producers have been given approval to raise tariffs.

Power shortages, expected to worsen this year, will help HPI to maintain its high utilisation rate. The company is expected to buy more plant from its parent, Huaneng Power Group. In addition, it has Greenfield projects in the pipeline that would add 46 per cent of installed capacity, thereby driving up earnings.

HUANENG POWER



SMP Graphic Source: Reuters

Core Pacific says that at its valuation of 14.5 times the forecast full-year 2004 price/earnings ratio it maintains its 12-month price target of HK$14.85, which offers 14.2 per cent upside potential on its January 16 price of $13. The counter closed at $13.55 on Wednesday.

WHAT THE BROKER SAID

About a year ago Sun Hung Kai Financial Group trimmed its target price for Beijing Capital International Airport to HK$2.26 from $2.30 but maintained its "buy" recommendation. The target was based on a valuation of 7.5 times enterprise value over earnings before interest, tax, depreciation and amortisation. Beijing Capital is the busiest airport in China.

In August the company said its first-half profit dropped 51.9 per cent to 110.36 million yuan, compared with 229.59 million in the 2002 period. Turnover fell 13 per cent to 893.44 million yuan.

Sars took its toll in the second quarter as passenger figures slumped 88.3 per cent between May 1 and 18 – the peak of the outbreak – from the same period in 2002. Aeronautical revenue dropped more than 15 per cent to 633 million yuan.

Operating costs rose more than 6 per cent to 675 million yuan.

In November it was reported that Beijing Capital would raise as much as 13 billion yuan over the next four years to expand the airport as it prepared for the 2008 Olympic Games. It had about 1.5 billion yuan cash on hand with cash flow estimated to be a billion yuan a year.

BEIJING CAPITAL AIRPORT

SMP Graphic Source: Reuters

This month the company said passenger numbers dropped 10.3 per cent last year to 24.36 million, despite positive monthly growth since September. The counter closed at $2.725 on Wednesday.

Analysts divided on rally in tech shares

The Independent in London

Nearly four years after technology shares went through the roof and then crashed to earth – destroying the savings of many investors – there are distinct signs of life in the technology sector once more.

Share prices of tech companies, which began rallying last year, have continued on an upward path this year and that looks set to continue for the short term at least.

Flotations of technology companies – something only a handful have managed over the past couple of years – are back on the menu. In a nutshell, London's appetite for technology seems to have returned.

For evidence of the revival in technology shares, look no further than the FTSE techMARK 100 index, which closed up another 0.86 points yesterday at 1,101.93 – not far off double last year's level.

Worryingly, though, some believe that the comeback that the technology sector has already staged, and which is gathering momentum, might have run out of steam before the end of this year.

The respected City technology analyst Richard Holway admits the technology sector is experiencing something of a "mini bubble" but warns that a correction could be on the cards later this year.

"I would almost stake my reputation on the fact that we are in a mini bubble and we believe that although it will clearly go on for some period – one or two quarters – we believe a correction will occur later in the year," Mr Holway, a director of the IT research consultancy Ovum Holway, said.

While that sounds gloomy, many will sit up and listen. The last time Mr Holway came out with such a contrary view, he was pilloried for it even though it later proved accurate. In the summer of 2000, he predicted that shares in internet companies still had far further to fall even though prices had already plunged.

Issues such as the year 2000 computing problem, work done on the introduction of the euro and the emergence of internet businesses powered technology stocks to peak prices in the spring of the year 2000. But the bubble burst not long after with share prices falling and, as Mr Holway predicted, they continued to drop. In the sectoral shake-out that followed, many technology companies disappeared altogether.

He reckons that this latest "mini bubble" started at the beginning of the third quarter of last year "because people were starting to see earnings growth coming through, although it was all because of cost savings".

Shares in the IT services company LogicaCMG are a prime example of the sector revival. Friday's closing price of 294.75p was about double where LogicaCMG stock was a year ago.

But Mr Holway has bad news. "Earnings expectations for 2005 just do not match with what we believe is happening ... and this will become very clear in the last half of this year, from Q3 onwards," he says, pointing to a second-half correction.

He is not alone. Another analyst, who did not want to be named, said: "There is a definite danger of another boom in prices ... valuations are below the peak but tech relative to the market is back at a significant premium."

But there are many analysts who point out that while technology share prices have risen sharply over the past year, in many cases doubling, they have come from a very low level. Seamus Keating, LogicaCMG's finance director, noted: "I think the depression was overdone ... so the shares have come from a really low base."

The techMARK index, launched at a base level of 3,000 points in October of 1999 and which surged to a high of nearly double that in March of the year 2000, hit its low of about 600 points last March.

That means valuations are nowhere near what they were at the peak, although they have doubled in the past year. One technology analyst said simply: "There's no bubble here." He pointed out that current earnings multiples for technology companies of about 20 times are far beneath the levels that were seen at the peak of the market when multiples shot up as high as 60-80 times.